

# INDEX

	Page
Opinions below.....	2
Jurisdiction.....	2
Questions presented.....	2
Statutes and regulations involved.....	3
Statement.....	3
Specification of errors to be urged.....	14
Reasons for granting the writs.....	15
Appendix.....	25

## CITATIONS

### Cases:

<i>Earle v. Commissioner</i> , 38 F. (2d) 965.....	15, 16
<i>Phillips v. Commissioner</i> , 283 U. S. 589.....	23
<i>Stone v. White</i> , decided May 24, 1937, No. 202.....	21, 23
<i>United States v. Arnold</i> , 89 F. (2d) 246.....	23
<i>United States v. Esnault-Pelterie</i> , 299 U. S. 201.....	20

### Statutes:

Revenue Act of 1918, c. 18, 40 Stat. 1057:	
Sec. 200.....	26
Sec. 210.....	21
Sec. 211.....	21
Sec. 212.....	25
Sec. 218.....	25
Sec. 219.....	27
Sec. 224.....	26
Sec. 225.....	27
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 280.....	23

### Miscellaneous:

Regulations 45:	
Art. 321.....	28
Art. 322.....	29
Art. 342.....	30
Art. 411.....	29
Art. 412.....	30
Art. 421.....	30
Art. 1521.....	31
Art. 1570.....	32
Uniform Partnership Act (Act of March 26, 1915, P. L. 18):	
Sec. 30.....	19
Sec. 33.....	19

# **In the Supreme Court of the United States**

OCTOBER TERM, 1937

---

No. 144

D. B. HEINER, INDIVIDUALLY AND AS FORMER COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF PENNSYLVANIA, PETITIONER

v.

A. W. MELLON

---

No. 145

D. B. HEINER, INDIVIDUALLY AND AS FORMER COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF PENNSYLVANIA, PETITIONER

v.

JENNIE KING MELLON, RICHARD KING MELLON, SARAH MELLON SCAIFE, AND THE UNION TRUST COMPANY OF PITTSBURGH, EXECUTORS OF THE ESTATE OF R. B. MELLON, DECEASED

---

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of D. B. Heiner, former Collector of Internal Revenue for the Twenty-Third District of Pennsylvania, prays that writs of certiorari issue to review the judgments

(1)

of the Circuit Court of Appeals for the Third Circuit, entered in the above causes on March 15, 1937, affirming the judgments of the District Court of the United States for the Western District of Pennsylvania.

#### OPINIONS BELOW

The opinion of the District Court (R. 148) in the case of *Heiner v. A. W. Mellon* is reported in 14 F. Supp. 424. The opinion of the District Court (R. 163) in the case of *Heiner v. Jennie King Mellon et al.* is unreported but is identical, except for names and amounts, with the opinion in the former case. The cases were consolidated for appeal and the opinion of the Circuit Court of Appeals (R. 709) is reported in 89 F. (2d) 141.

#### JURISDICTION

The judgments of the Circuit Court of Appeals were entered on March 15, 1937 (R. 712-713). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

#### QUESTIONS PRESENTED

1. Whether partnership earnings continued to be taxable annually after the death of a partner.
2. In the alternative, whether such earnings are annually reportable by and taxable to the surviving partners as fiduciaries of trust estates pending final termination of partnership affairs. If so, whether the application of *Stone v. White*, decided

by this Court on May 24, 1937, does not defeat recovery.

#### STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra*, pp. 25-32.

#### STATEMENT

These actions were separately instituted by respondents A. W. Mellon and R. B. Mellon (R. 1, 3) for the refund of individual income tax deficiencies assessed and paid for the calendar year 1920, upon net earnings of two partnerships dissolved by the death of a partner. Juries were waived and the cases were consolidated and tried before Judge Gibson, at Pittsburgh, October 29-31, 1934 (R. 318). Special findings of fact (R. 148-155, 163-169) and conclusions of law (R. 155, 169-170) were entered by the court and judgments were rendered thereon in favor of respondents for \$202,502.22 and \$187,787.17, respectively, with interest (R. 2, 4). Except for amounts, the facts are the same in each case. The special findings, as supplemented by uncontradicted evidence, are as follows:

On December 12, 1918, respondents and H. C. Frick entered into two separate partnership agreements (R. 15-19) for the sole purpose of continuing the liquidation of the two corporations, A. Overholt & Co. and West Overton Distilling Company (R. 351d, 354, 365) which existed for many years as whiskey distilleries, and whose entire capital stock was owned by respondents and Frick in

one-third interests. The agreements provided that in case of dissolution by death the surviving partners "shall have full power and authority to appoint" a "liquidating agent, with such power and authority to wind up and liquidate the affairs of said partnership as to such surviving partner or partners shall seem advisable" (R. 17, 19).

On January 1, 1919, the corporate assets, which included large whiskey inventories in bonded warehouses, were conveyed to the respective partnerships (R. 17, 18, 156) whose businesses consisted primarily of the storage, bottling, casing, and sale of the whiskey inventories (R. 351a, 354-355). The District Court found (Fdg. 11, R. 151, 166) that "The books and records of the liquidating trustees for said former partnerships were kept on the cash receipts and disbursements basis of accounting."<sup>1</sup>

On December 2, 1919, Frick died (R. 151), but until January 31, 1921, the partnership businesses were continued and carried on in exactly the same manner as prior to his death, without any change whatsoever with respect to the liquidation businesses for which the partnerships were formed, or with respect to their places of business, policies, management, bank accounts, bookkeeping, or otherwise (R. 366-367). Their operations in 1920 were

<sup>1</sup> The books and records of both companies during 1920 and prior thereto were actually kept on the accrual basis (R. 511, 351e, 351g, 352b, 448d, 450e, 448c, 450b-450d); counsel for respondents so admitted (R. 511) and the District Court expressly so states in its opinion (R. 159, 173).

exactly as carried on during 1917, 1918, and 1919 by the predecessor corporations and the partnerships prior to Frick's death, except that in 1920 it was necessary to obtain permission from the Federal Government to withdraw whiskey from the bonded warehouses and, upon withdrawal, it had to be bottled for the purchaser, which was not true prior to 1920 (R. 367, 354).

R. B. Mellon received \$5,000 annually for his services as "managing partner", both prior to and during 1920 (R. 351h, 353). Dewalt J. Hicks was treasurer of A. Overholt & Co. until January 31, 1921, and signed all checks and was overseer of both companies (R. 353, 357).

On January 31, 1921, Messrs. Mellon, as surviving partners of each company, entered into trust indentures (R. 19-32) with the Union Trust Company of Pittsburgh, pursuant to the authority vested in them by the partnership agreement to appoint a liquidating agent, whereby all remaining real and personal assets were sold and transferred to the Trust Company which was vested with full legal title thereto and power to "carry on and manage, as it may be permitted under the law so to do, the business of the said copartnership, with full discretion on its part to dispose of said copartnership property \* \* \*" (R. 23, 29). The indentures were recorded with the Land Records and United States Patent Office, the assets including trade-marks (R. 20-21, 25, 27, 31).

During 1920, A. Overholt & Co. realized a net income of \$845,339.86 and West Overton Distilling Company \$158,442.84 in the ordinary course of business, derived chiefly from whiskey sales from the aforesaid inventories (R. 115-116, 126-127, 396).

During 1920, A. W. Mellon and R. B. Mellon withdrew from A. Overholt & Co. the aggregate sum of \$900,000 which was debited to bills receivable and credited to cash. Between January 3 and January 21, 1920, R. B. Mellon restored \$150,000 on account of previous withdrawals during 1918 and 1919 (R. 593). The bills receivable account described all these withdrawals as "loans" (R. 592a, 594). On February 10, 1921, respondents and the Frick estate withdrew \$400,000 each, or \$1,200,000 in cash (R. 597). These and further cash withdrawals by the three interests from A. Overholt & Co. between Frick's death and August 18, 1925, aggregated \$2,480,000 (R. 592a), of which \$2,130,000 was never returned by respondents and the Frick estate, except that the bills receivable account shows final offsetting and closing bookkeeping entries dated December 31, 1925, and February 11, 1926 (R. 592a), after completion in 1925 of the liquidation of all assets of A. Overholt & Co. by the Union Trust Company of Pittsburgh, as trustee (R. 349, 350).<sup>2</sup>

---

<sup>2</sup> However, the District Court found (Fdg. 15, R. 152, 167) that the Mellons, "while acting in the capacity of liquidating trustees, kept the assets of the said former partnerships, in-

All assets of West Overton Distilling Company on hand January 31, 1921, were sold by the Trust Company, as trustee, by August 31, 1925 (R. 490d). All remaining moneys or assets of both companies were distributed prior to December 31, 1925, and each third interest received total distributions in excess of \$551,914.70 from A. Overholt & Co. and in excess of \$66,673.42 from West Overton Distilling Company (R. 130, 131, 143, 144, 485b, 486b).

On March 15, 1921, the Mellons filed separate individual returns for the calendar year 1920 (R. 404a-404c, 406a-406c); also separate returns, on official partnership forms, in the name of A. Overholt & Co. and West Overton Distilling Company, for 1920, each sworn to by R. B. Mellon as "Member of partnership" (R. 351, 352). The returns represented the companies as partnerships, set forth R. B. and A. W. Mellon and the Frick estate as "Members of partnership", each with a one-third "Interest in partnership", and stated that there was distributable and taxable to each \$48,350.74 from A. Overholt & Co. and \$5,960.55 to each from West Overton Distilling Company derived from storage, bottling, and casing operations; the sale of barrels, interest, and rental (R. 351, 352).

No fiduciary return was ever filed or caused to be filed for 1920, by respondents or anyone else as liquidating agents, liquidating trustees, or other-  
cluding cash, separately, treating the same as trust properties, and did not commingle such assets or cash with their own assets or cash."

wise, with respect to the income of either company (R. 122, 135, 392).

The partnership return of A. Overholt & Co. (R. 351d) disclosed a net profit on whiskey sales during 1920 of \$646,327.63, which was not included in the distributable net income shown on the face of the return; neither did the West Overton Distilling Company partnership return include in net income the whiskey profits realized by it during 1920.

The Revenue Agent and Commissioner, in examining the partnership returns, accepted the partnership basis for the reporting of 1920 income but increased the incomes reported as distributable by adding the whiskey profits thereto (R. 387, 388), thus determining A. Overholt & Company's 1920 net income to be \$845,339.86, distributable one-third each to the Mellons and the Frick estate (R. 387). The West Overton Distilling Company's 1920 net income was, likewise, increased to \$158,442.84 distributable one-third each to the Mellons and the Frick estate (R. 388).

In accordance with the partnership income adjustments, the Commissioner increased the distributable one-third shares of A. W. and R. B. Mellon in their individual returns for 1920 to \$281,779.95 each from A. Overholt & Co. and \$52,814.28 each from West Overton Distilling Company (R. 327, 340), they having reported their distributable shares from the two companies at \$48,350.74 and \$5,960.55, respectively (R. 404a, 406a).

Separate returns for 1921 to 1925, inclusive, were made by the Union Trust Company, describing itself as liquidating agent for each company.

On December 20, 1922, the Commissioner sent letters to the Mellons showing individual tax deficiencies for 1920 (R. 433, 438). On January 19 and January 20, 1923, the Mellons filed protests thereto, asserting solely that the Commissioner erred in reducing the March 1, 1913, value of the good will of A. Overholt & Co. and in failing to allow the value claimed for good will (R. 452a-452n, 453-455). The addition of whiskey profits to distributive partnership shares was not questioned.

On December 16, 1926, after re-auditing the individual returns and considering the Revenue Agent's report of November 8, 1921, and the protests in connection therewith, the Commissioner separately advised the Mellons by letters that additional individual taxes were shown to be due for 1920, and that a hearing would be afforded (R. 421-432).

On January 31, 1927, the Mellons filed further protests directed to the Commissioner's findings in letters of December 16, 1926. The protests questioned only the refusal to allow as deductions certain donations, items of good will, trade-marks, etc., in connection with A. Overholt & Co., a corporation (R. 457-462). Supporting briefs were filed, simply enlarging upon deductibility of the donations. No suggestion or assertion was made

that the partnerships should be treated in any other manner than as partnerships for 1920 tax purposes (R. 463-472).

On February 21, 1927, sixty-day letters were sent to A. W. and R. B. Mellon, showing deficiencies in their individual 1920 income taxes of \$190,419.70 and \$175,529.70, respectively (R. 411-419). On February 21, 1927, A. W. Mellon executed a waiver (R. 474) of his right to file a petition with the Board of Tax Appeals and consented to immediate assessment and collection of the deficiency which, with interest of \$12,082.52, was assessed on March 19, 1927 (R. 474), and paid April 1, 1927.<sup>3</sup>

On May 5, 1927, the deficiency, with interest of \$12,527.47, was assessed against R. B. Mellon (R. 474), he having filed no petition with the Board and, upon notice, the assessment was paid May 19, 1927.

On May 19, 1929, the Mellons filed separate claims for the refund of \$194,160.75 and \$187,787.17, respectively, for 1920, each claim containing identical grounds (R. 349-349b, 350-350b).

By letters of April 16, 1932, the Commissioner advised respondents their claims would be rejected for the reason that operating incomes of the two companies in 1920 were reportable for tax purposes for that year (R. 475-478). Respond-

<sup>3</sup>The District Court found (Fdg. 7, R. 150) that A. W. Mellon paid the assessment "under written protest and for the purpose of avoiding additional interest, penalties and seizures."

ents requested and were given hearings on October 12, 1932, and submitted a joint brief in connection therewith on November 22, 1932 (R. 572a). Their brief abandoned the grounds relied upon in the refund claims and asserted for the first time that the partnership incomes should have been treated in 1920 as the income of taxable trusts for which both the Mellons were taxable as liquidating trustees and not individually as to distributive partnership shares (R. 572a-572h).

If these partnerships were taxable trusts during 1920, tax liabilities of \$551,914.70 (R. 393-394) and \$66,673.42 (R. 394-395) were admittedly incurred by A. W. and R. B. Mellon, as trustees, with respect to the 1920 net incomes of A. Overholt & Co. and West Overton Distilling Company, respectively, but the Commissioner and the United States were precluded by limitations from assessing and collecting such tax liabilities for 1920, when the Mellons first asserted they were taxable as liquidating trustees (fiduciaries) in their brief filed November 22, 1932, unless it be held that the failure to file fiduciary returns shall be considered to be a failure to file any return at all, notwithstanding the filing of partnership returns.

On October 24, 1933, the statements of claim were filed (R. 6, 33). On December 1, 1933, R. B. Mellon died and on March 21, 1934, his executors were duly substituted (R. 60, 61).

By letters of February 27, 1934, the Commissioner advised respondents that their proportion-

ate shares of operating profits of the two companies were "properly reportable on your 1920 return" and that "accordingly, the claim will be disallowed" (R. 401-402, 480-481). Both claims were rejected April 6, 1934 (R. 402-403, 479).

Claims for refund were also filed by each of the Mellons for 1925, and are now pending before the Commissioner for his decision thereon (R. 508, 510). These claims seek a refund for 1925 with respect to inclusion by the Commissioner in their individual incomes of all operating profits and losses for the years 1920 to 1925 of the two companies. The claims allege they were filed as a matter of protection against the running of the statute of limitations for 1925, if it be finally determined that the Commissioner was wrong as to 1925 and right as to 1920 (R. 508c, 510c). These claims state that since filing the 1920 claims, respondents received letters from the Commissioner advising that he "had erroneously included in taxable income in the year 1925, the operating profits and losses of said liquidating agent during the period of liquidation." The 1925 claims have not yet been finally acted upon because of these actions (R. 512).

The statements of claim are based on the contention that the amounts of \$281,779.95 and \$52,814.28, consisting of profits on whiskey sales during 1920 by A. Overholt & Co. and West Overton Distilling Company, respectively, were erroneously included in each of the Mellons' 1920 individual

incomes as taxable, for the reason that the partnerships were in liquidation and such amounts, being liquidating profits, were not reportable or taxable until completion of liquidation and distribution in 1925 (R. 14); that until the cost values of the partnerships as of December 2, 1919, were fully recovered, their individual distributive shares in partnership profits were not taxable (R. 11) and that such cost basis was not exceeded until 1925; that the Mellons were liquidating trustees for the partnerships during 1920 (R. 9), that the "liquidating profits" for 1920 were included by the Commissioner in A. W. and R. B. Mellon's individual incomes for 1925, and that a tax has been collected on the same income for each of those years (R. 14).

The Government contended in the courts below, among other things, that the amounts involved represent taxable distributive shares of the operating incomes and profits of the partnerships for 1920. It argued in the alternative that if the respondents were correct in their position that fiduciary, instead of partnership, returns should have been filed for the partnerships for 1920, the tax properly payable by the respondents as fiduciaries would exceed that actually paid by the respondents, and that therefore the amounts collected from the respondents were justly owing to the United States.

The trial judge held that the return was properly made on a partnership basis, but that the gain from the sale of whiskey in 1920 was not taxable as

income in that year because the whiskey had been converted by the death of the deceased partner and dissolution of the partnerships from stock in trade to "capital assets." The Circuit Court of Appeals affirmed the judgments of the trial court, holding, however, that "The surviving partners, under a mistake of law, filed returns as a partnership rather than as liquidating trustees."

**SPECIFICATION OF ERRORS TO BE URGED**

The Circuit Court of Appeals erred:

1. In failing to hold that the 1920 net incomes, including profits on whiskey sales, of the co-partnerships of A. Overholt & Co. and West Overton Distilling Company, were reportable under Section 224 of the Revenue Act of 1918, on the partnership basis, and taxable under Section 218 of the Act.

2. In failing to reverse the judgments because not supported by the special findings.

3. In failing to reverse the determination of the District Court that in 1920 liquidation of the partnerships was undertaken.

4. After deciding that the surviving partners should have filed returns as liquidating trustees instead of as partnerships, in failing to hold that the surviving partners were taxable as fiduciaries under the Revenue Act of 1918, and in not holding that the trial court should have made findings with respect to the 1920 fiduciary tax liabilities of the surviving partners for the purpose of determining whether the Government has been unjustly en-

riched by reason of the payment of the taxes in question in the present cases.

5. In affirming the judgments of the District Court.

#### REASONS FOR GRANTING THE WRITS

1. The decision of the court below is in conflict in principle with the decision of the Circuit Court of Appeals for the First Circuit in *Earle v. Commissioner*, 38 F. (2d) 965. In that case a partnership, formed January 1, 1923, was dissolved July 1, 1923, by death of one of three partners. On September 14, 1923, the partnership was wound up by conveyance of the partnership interests to a corporation in exchange for stock. The partnership made a net profit of \$70,793.37 between January 1, 1923, and dissolution on July 1, 1923. Its assets were being used in another enterprise which was not completed until July 1924. Whether the enterprise would result in a gain or loss could not be ascertained during 1923. The partners urged (p. 967) that they "could not be taxed for the reason that the proper tax must be measured by the 'distributive share' of each partner, and that no share of the profits was 'distributive' until the balance of the assets over return of capital was ascertained." This is the contention which the lower court has here upheld. In rejecting that contention in the *Earle* case, *supra*, the court held (pp. 967-968):

If the word "distributive" were to be limited to the share each partner receives from

actual distribution of profits, either from a going concern or upon dissolution of the partnership, the words of the statute "whether distributed or not" become meaningless. Each partner has a potential right to his share of undivided profits. Plainly, the word "distributive" is used in the sense of "proportionate." It is the partner's proportionate share of the net income of the partnership gained during the taxing period that is taxable whether distributed or not. Losses suffered during the same period are allowed as deductions from partnership gross income in arriving at net profits.

\* \* \* \* \*

Any contention that net income for the taxable year 1923 would be wiped out by losses expected in future years is untenable. Income taxes are levied upon the net income for an annual accounting period. Gains in one period may not be offset by losses in another; therefore there was no deductible loss in 1923 unless it was sustained when partnership assets were exchanged for corporate stock.

The applicable provisions of the Revenue Act of 1918 are identical with the provisions of the 1921 Act under consideration in the *Earle* case, *supra*.

2. If the decision herein is allowed to stand, it will result in escape from taxation of income actually realized by the partnership during 1920, by allowing reduction thereof by any operating losses

occurring in subsequent years. The principle would also be a dangerous precedent by affording a "loophole for tax evasion."<sup>4</sup>

Finding 24 (R. 169) that the Commissioner has assessed and collected a tax on the same income for both 1920 and 1925, is unwarranted because the evidence shows that claims for refund were also filed by each of the Mellons for 1925, which claims are now pending before the Commissioner for his decision thereon (R. 508-510). The 1925 claims state that they were filed as a matter of protection against the running of the statute of limitations for 1925, if it be finally determined that the Commissioner was right as to 1920 and wrong as to 1925. The 1925 claims have not been finally acted upon because of the instant actions (R. 512).

The court below held that upon the death of Frick in 1919, the partnerships dissolved and by reason of such dissolution their assets changed character from stock in trade to capital assets, so that no taxable gain was realized until the surviving partners and estate of the deceased partner actually received amounts in excess of the cost values to each of them of their partnership interests as of Frick's death, and of the undistributed net income on which a tax had been paid; that there were no means of determining whether profit or loss resulted from the sale of the assets, including

---

<sup>4</sup> See Vol. 3, 1936 C. C. H., p. 6640, where the phrase is used in discussing the present decision.

whiskey inventories, until the proceeds should exceed such bases. There is no statute or provision of law which supports such holding.

Article 1570 of Regulations 45, cited and relied upon below, has never been construed or applied in the manner attempted. Article 1570 deals with the taxability of a surviving partner who has actually received a liquidating dividend, as distinguished from his distributive share in annual earnings during winding up of partnership affairs. The article has no relation to taxability to individual partners, according to their distributive shares, whether distributed or not, of annual gains upon sales of stock in trade or other operating income pending final termination of partnership affairs.

The court below failed to distinguish between the actual receipt by partners of distributions in partial or complete repayment of their individual partnership investments, and the actual receipt by the partnership of taxable annual earnings from partnership operations and the sale of inventories of merchandise held primarily for sale.

Section 224 of the Revenue Act of 1918 requires every partnership, without exception or qualification, to make a return for each taxable year, stating specifically the items of gross income, the deductions allowed, and the names and addresses of the individuals who would be entitled to share in the net income "if distributed and the amount of

the distributive share of each individual." Such partnership returns were so filed by the Mellons, the Commissioner merely increasing their distributable net incomes by the addition of whiskey profits.

The District Court, in its opinion (R. 176), quoted the following applicable provisions of the Uniform Partnership Act of Pennsylvania (identical with the common law) :

On dissolution the partnership is not terminated but continues until the winding up of partnership affairs is completed.

Sec. 30, Act of March 26, 1915 (P. L. 18).

Except so far as may be necessary to wind up partnership affairs, or to complete transactions begun but not then finished, dissolution terminates all authority of any partner to act for the partnership.

Sec. 33, Act of 1915.

Thereupon, the District Court stated (R. 176) :

In addition to the quoted provisions of the Uniform Partnership Act of Pennsylvania, which provide for the continuance of the business of the partnership for the limited purpose stated therein, *a continuance of the partnership after the death of a partner was contemplated by the partnership agreements, which gave surviving partners the right to appoint a liquidating agent.* As stated, these questions are moot, in view of the finding that the gains of 1920 did not constitute income from the sale of a stock in

trade, but were proceeds from the sale of capital assets which had not, in that year, equaled the amount of the cost bases to the former partners; and the further finding that such gains, in the hands of the surviving partners in trust for the Estate of H. C. Frick, as well as for themselves, were not distributive in 1920. [Italics supplied.]

The District Court recognized that the partnerships continued in existence in 1920, but did not consider it important that, under applicable partnership law and the partnership agreements, the partnerships did not terminate upon Frick's death. But the Circuit Court of Appeals predicated its decision upon the fact of dissolution by death saying that thereupon no gain was realized until the amounts received by the several interests exceeded the cost to them of their respective interests. However, the District Court's findings are incomplete. It failed to find what was the cost basis of each of the Mellons, or the date as of which such cost basis shall be fixed and what, if anything, had been recovered by each on account thereof prior to 1920, as well as during that year, all being indispensable findings, if the court's legal conclusions be held correct. Cf. *United States v. Esnault-Pelterie*, 299 U. S. 201.

The statement of the Circuit Court of Appeals (R. 711) that such cost bases were conceded to be \$990,755.53 and \$60,505.66, respectively, and that it is unquestioned that they were greater than the proceeds of whiskey sales in 1920, is inaccurate.

No such concession was made, nor does the record so show. The District Court made no such finding,<sup>5</sup> nor did it find what, if anything, was realized between Frick's death and January 1, 1920. There were also other operating incomes than that from whiskey.

It follows that the findings on their face fail to support the judgments and that the decision is untenable.

3. If the findings that the respondents were liquidating trustees (Fdg. 10, R. 151) and that they treated the assets of the partnerships as trust properties (Fdg. 15, R. 152) during 1920 be held correct, it follows that the decision below is in direct conflict with and contrary to the holding of this Court in *Stone v. White*, decided May 24, 1937, No. 202, for the reason that the respondents were then taxable as fiduciaries of trust estates within the definition of Section 200 of the Revenue Act of 1918, under Sections 210 and 211 by virtue of Sections 219 (a) and 225 of that Act.

<sup>5</sup> The District Court found (Fdg. 23, R. 154-155, 169) that "The sum received from the sale of whiskey certificates \* \* \* in 1920, and prior thereto during the existence of the partnerships, was less in amount than the cost of the assets of said companies to the partners, \* \* \*." This conclusion is not supported by any findings of governing data for determination of cost basis, of amount of cost or recoverable basis in dollars or of the amounts received by the partnerships from other operations than sales of whiskey inventories. The A. Overholt & Co. 1920 return (R. 351f) shows the receipt of \$165,868.40 as "Gross Income From Operations Other Than Manufacturing."

The respondents, in their brief filed in support of their claims (R. 572a-572h), asserted that the partnership incomes should have been treated in 1920 as the income of taxable trusts for which both the respondents were taxable as liquidating trustees and not individually as to their distributive partnership shares.

On the basis of the partnership incomes determined by the Commissioner for 1920, tax liabilities of \$551,914.70 (R. 393-394) and \$66,673.42 (R. 394-395) were incurred by A. W. and R. B. Mellon, as trustees, with respect to the 1920 incomes of A. Overholt & Co. and West Overton Distilling Company, respectively, and it is admitted (R. 398) that the Commissioner and the United States were precluded by limitations from assessing and collecting such tax liabilities for 1920, when the Mellons first asserted they were taxable as liquidating trustees (fiduciaries) in their brief (R. 572a-572h) filed November 22, 1932, and in their claims for refund departing from the partnership basis of reporting and taxing their incomes. In any event, petitioner was entitled to have his equitable defenses ruled upon under the principles outlined by this Court in *Stone v. White*, *supra*.

The applicability of *Stone v. White*, *supra*, is obvious because the Mellons were not only the "apparent" but "real" taxpayers, being surviving partners, fiduciaries, transferees, ultimate beneficiaries, and distributees respecting partnership assets in

amounts admittedly in excess of the fiduciary tax liabilities. Had the Mellons asserted prior to the running of the statute of limitations that they were taxable fiduciaries, the Commissioner could have made a transferee assessment under Section 280 of the Revenue Act of 1926, which was applicable to tax liabilities imposed by all prior Revenue Acts and transfers prior to its enactment. *Phillips v. Commissioner*, 283 U. S. 589.

It is patent that the Circuit Court of Appeals applied the same views to petitioner's equitable defenses herein as it did in the case of *United States v. Arnold*, 89 F. (2d) 246 (C. C. A. 3d), decided February 4, 1937, wherein it said (p. 247):

We do not see that a mistake of judgment or any cause or reason for failure to tax one affects the legal rights of others.

This Court granted certiorari in *Stone v. White*, *supra*, because of the conflict between it and the *Arnold* case.

A further indication of such view of the court below is the conclusion in its opinion that the surviving partners under a mistake of law erroneously filed a partnership return and that the Commissioner under a similar mistake of law erroneously accepted such return, thus rejecting the equitable defense just as in the *Arnold* case. The instant decision was rendered approximately five weeks after rendition of the *Arnold* opinion.

Because of the importance of the questions involved and the opportunity created by the decision

for the evasion of taxes respecting the income of partnerships and the probable conflict of decisions, it is respectfully submitted that this petition for writs of certiorari should be granted.

STANLEY REED,  
*Solicitor General.*

JUNE 1937.

## APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057:

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226.

SEC. 218. (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive

share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

The partner shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the partnership.

\* \* \* \* \*

(d) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212, except that the deduction provided in paragraph (11) of subdivision (a) of section 214 shall not be allowed.

\* \* \* \* \*

SEC. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

SEC. 200. That when used in this title—

\* \* \* \* \*

The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any

fiduciary capacity for any person, trust or estate;

\* \* \* \* \*

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration of settlement of estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, \* \* \*

SEC. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is \$1,000 or over if single or if married and not living with husband or wife, or \$2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is \$1,000 or over or if any beneficiary of such estate or trust is a nonresident alien, stating specifically the

items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

#### TREASURY REGULATIONS 45:

ART. 321. *Partnerships.*—Partnerships as such are not subject to taxation under the statute, but are required to make returns of income. See section 224 of the statute and articles 411 and 412. Individuals carrying on business in partnership are, however, taxable upon their distributive shares of the net income of such partnerships, whether distributed or not, and are required to include such distributive shares in their returns. The net income of a partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that the deduction of contributions or gifts is not permitted. See section 212 and articles 21–26. As to the excess profits tax on partnerships with fiscal years ending in 1918 see section 335 (c).

ART. 322. *Distributive shares of partners.*—The distributive share of the net income of a partnership which a partner is required to include in his return is his pro-

8

portionate share of the net income of the partnership, either (a) for the taxable year upon the basis of which the partner's net income is computed, or (b), if the partner's net income is computed upon the basis of a taxable year different from that upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed. Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable year.

ART. 411. *Partnership returns.*—Every partnership must make a return of income, regardless of the amount of its net income. The return shall be on form 1065 (revised) and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership; that is, for its annual accounting period (fiscal year or calendar year as the case may be), irrespective of the taxable years of the partners. See section 218 of the statute and articles 321-327. If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 226 and article 431. See also article 424.

ART. 412. *Contents of partnership return.*—The return of a partnership shall state specifically (a) the items of its gross income enumerated in section 213 of the statute; (b) the deductions enumerated in section 214, other than the deduction provided in paragraph (11) of subdivision (a) of that section; (c) the amounts specified in subdi-

visions (a) and (b) of section 216 received by the partnership; (d) the amount of any income, war profits and excess profits taxes of the partnership paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year; (e) the names and addresses of the individuals who would be entitled to share in the net income of the partnership if distributed; (f) the amount of the distributive share of such net income of each such individual; and (g) such other facts as are required by form 1065 (revised). See also sections 222 and 227 and articles 381-385 and 441-448.

ART. 342. *Estates and trusts taxed to fiduciary.*—In the case of (a) estates of decedents before final settlement and of (b) trusts, whether created by will or deed, for accumulation of income, whether for unspecified persons or persons with contingent interests or otherwise, the income is taxed to the fiduciary as to any single individual, except that from the income of a decedent's estate there may first be deducted any amount of income properly paid or credited to a beneficiary. \* \* \*

ART. 421. *Fiduciary returns.*—Every fiduciary, or at least one of joint fiduciaries, must make a return of income (a) for the individual whose income is in his charge, if the net income of such individual is \$2,000 or over if married and living with husband or wife or is \$1,000 or over in other cases, or (b) for the estate or trust for which he acts, if the net income of such estate or trust is \$1,000 or over or if any beneficiary of such estate or trust is a nonresident alien. The return in case (a) and also in case (b) if the tax is payable by the fiduciary shall

be on form 1040 (revised), except that it may be on short form 1040A (revised) where the net income does not exceed \$5,000. The return shall be on form 1041 (revised) in case (b) if the tax is payable by the beneficiaries. In such a case the fiduciary shall include in the return a statement of each beneficiary's distributive share of the net income, whether or not distributed before the close of the taxable year for which the return is made. See section 219 of the statute and articles 341-347. If the net income of a decedent from the beginning of the taxable year to the date of his death was \$1,000 or more, if unmarried, or \$2,000 or more, if married, the executor or administrator shall make a return for such decedent. See article 305.

ART. 1521. *Fiduciary*.—"Fiduciary" is a term which applies to all persons that occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators, and a fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another as in the case of receivers. A committee of the property of an incompetent person is a fiduciary. See sections 219 and 225 of the statute and articles 341-344 and 421-425.

ART. 1570. *Readjustment of partnership interests*.

When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him or (if acquired prior thereto) the fair market value as of March 1, 1913, of his interest in the partnership, including in such

cost or value the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. See article 1566. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain or loss has been realized by any partner. See also article 1563.